COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN INVESTIGATION INTO DIVERSIFIED OPERATIONS OF LOCAL EXCHANGE TELEPHONE COMPANIES	)))	ADMINISTRATIVE CASE NO. 340

O R D E R

The Commission, on its own motion, initiated this case by Order dated October 25, 1991 to investigate diversification of local exchange carriers ("LECs"). As a part of this investigation, the Commission propounded a series of questions regarding LEC investment in cellular operations in recently opened rural service areas ("RSAs"). All LECs were made a party to the case. After reviewing the answers provided by the LECs, the Commission finds that new concerns have been raised by the first set of responses. Therefore, in order to gather more information, the Commission will require those LECs which have used telephone company assets to invest, either directly or indirectly, in cellular activities to provide answers to the following questions within 30 days from the date of this Order.

All Companies (as described above)

1. a. Provide any agreements or contracts between the telephone company and the cellular managing partner or switch partnership manager relating to any rental agreements between the entities. Provide contracts and contract amounts with studies,

analysis, or any other financial computations which support rental lease amounts.

b. Provide an explanation of where these amounts are recorded in the books of the telephone company and the USoA authority for such classification.

c. Should these amounts be tariffed? If no, explain why not.

d. Does any LEC ultimately plan to finance the cellular operations on a permanent basis through Rural Telephone Bank ("RTB"), Rural Telephone Finance Corporation ("RTFC") or another institution? If so, give details and describe what will happen to monies invested by the LECs.

2. Provide detailed cost allocation procedures, using the procedures outlined in Administrative Case No. 321,[1] Order dated December 22, 1988 as a guideline, showing for each account the procedures to allocate costs from the regulated accounts of the telephone company to the accounts of any subsidiary or the accounts of the cellular partnership. The procedures set out in Administrative Case No. 321 may not apply to every account maintained by the company; where an account would not conceivably need to be allocated indicate that this account is not applicable. Where a holding company relationship exists, the holding company allocation procedures should be supplied.

---

1 Administrative Case No. 321, Separation of Costs of Regulated Telephone Service From Costs of Nonregulated Activities.

3. If the company has established a subsidiary, explain how the subsidiary is capitalized. What evidence of investment in the subsidiary does the telephone company have?

4. How are revenues and expenses recorded when a company acts as an agent selling cellular equipment? How have common costs been allocated?

5. Submit a copy of your company's cellular partnership agreement or make reference to your company's agreement filed by another partner in this case.

6. Is it your opinion that the Commission does or does not have the authority to determine a utility's ideal capital structure and prevent impairment of a utility's capital? Explain your response completely.

7. If it is your position that the Cost Allocation Manuals ("CAMs") provide for the allocation of costs to ventures other than non-regulated ones, explain in detail how this can be accomplished given that CAMs are intended to separate costs between regulated and nonregulated accounts only.

8. Explain why the utility choose to enter into a particular type of partnership agreement (e.g., general partnership rather than limited partnership). To what degree does the type of partnership agreement limit the liability of the LEC?

9. Are revenues from the sale of cellular equipment and revenues received from supplying minutes of use treated differently when recorded on the telephone company's books? If yes, explain why.

10. Should future cellular cash outlays be financed by the cellular company without infusion from the partners? If no, why not?

11. Explain how establishment of a separate subsidiary would limit the possibility of a legal liability for the parent cooperatives. To what degree does it limit this liability?

12. Provide the amount of investment or capital costs made to the partnership as of the most recent date. Shouldn't equal percentage investments by partners equate to equal dollar investments? If not, why?

<u>All RTC's</u>

13. In determining a telephone company's revenue requirements, should the investment in cellular operations be included in the determination of rate base and capital and shall the LEC's share of partnership net income be included in revenue requirements? Explain in detail your answer.

14. Do you agree that absent the investment in cellular investment and contributions to capital calls, the cash used for these items would have eventually been returned to the membership in the form of capital credits? If no, explain. In the event that cellular operations are not profitable, can it be concluded that capital credits would be diminished? Will profits from cellular operations be pooled with other cooperative revenues to supply capital credits to members? If no, why not?

15. Provide any economic or financial analysis related to the cellular partnership reflecting profit expectations. If none

have been prepared, provide estimates of when the partnership will become profitable.

16. Assuming that cellular operations are successful, will the cooperative's tax status be impacted by recognizing non-member revenues on the books of the cooperative?

Logan Telephone Company ("Logan")

1. The answer to Item 1 of the Commission's October 21, 1991 Order indicates that Logan and Cellular Division of Logan Telephone have a common board of directors. Explain how costs associated with this board are allocated between the two entities.

2. Explain why Logan accounts for its cellular investment in nonregulated accounts. Cite the authority in Part 32 which allows this classification.

3. With reference to the answer to Item 8 of the October 25, 1991 Order, explain how formation of a separate subsidiary provides tax flexibility. Be specific.

4. With reference to the answer to Item 14(b)of the October 25, 1991 Order, explain precisely why Logan's ratepayers will not be directly liable for costs associated with cellular investments, but will receive the benefits of any investment made by Logan.

5. What expenses are associated with the partnership locating its headquarters at your office? Explain how these expenses are accounted for.

Brandenburg Telephone Company ("Brandenburg") (All references relate to Case No. 91-260)

1. With regard to the answer to Item 1, second paragraph, would cellular telephone service have been brought to rural and

surrounding areas of Kentucky served by Brandenburg had Brandenburg not had surplus cash to invest in the cellular partnership? If no, explain.

2. In the answer to Item 2, explain in detail why the partners would have no interest in subsidizing their cellular operations if such subsidy would make the cellular operations profitable quicker and if such subsidy could be recouped from Brandenburg's ratepayers.

3. Explain what is meant by "arms-length" when describing transactions between Brandenburg and its cellular operations.

4. In the answer to Item 3 in the very first section, you seem to indicate that cellular operations are non regulated. Explain.

5. What expenses are associated with the partnership locating its headquarters at your office? Explain how these expenses are accounted for.

<u>Duo County Telephone ("Duo County")</u>

1. How was Duo County's wholly-owned subsidiary capitalized? Does Duo County consider investment in another entity through the use of regulated surplus cash cross-subsidization? If no, why not?

2. In response to Item 2 of the October 25, 1991 Order, the statement is made that all direct investments have been made by Cumberland Cellular, Inc. ("Cumberland"). From where did Cumberland obtain the funds which it invested?

3. Explain why small company regulatory costs would be increased if the Commission moved beyond the current level of

regulation and review. Give examples of these costs and estimates of these amounts.

Alltel Kentucky, Inc. ("Alltel")

1. Does Alltel's parent participate in cellular operations through a separate subsidiary? If yes, provide a description of these activities.

2. In your answer to Item 14(a) of the October 25, 1991 Order, you seem to differentiate between cellular service and traditional telephone service. Explain your rationale for making this distinction.

3. In Item 14(c) do you equate cellular service with deregulation? Explain.

Peoples Rural Telephone Cooperative Corporation, Inc. ("Peoples")

1. Relative to your response to Item 3 of the October 25, 1991 Order, explain why labor, benefits, and other overheads are charged to Account 6278.XX. On what basis does Peoples consider this a non-regulated administrative account?

2. Explain the second paragraph of the answer to Item 3 of the October 25, 1991 Order. What equipment space is being discussed? Provide a copy of the allocation procedure.

GTE South Incorporated

1. Given that the small telephone companies do not price on a cost basis, how can marginal cost criteria be applied to them?

Ballard Rural Telephone Cooperative Corporation, Inc.

1. Explain the rationale and the authority for accounting for partnership investment, cash infusions, and partnership losses

as suggested in your response to the October 25, 1991 Order, Item 3.

South Central Rural Telephone Cooperative Corporation

1. With reference to the answer to Item 3 of the October 25, 1991 Order, explain why the minor expenses for partnership meetings and administration mentioned in this answer are "directed" to non-regulated accounts.

2. Explain what is meant by a "sub-agent."

3. The answer to Item 4 of the October 25, 1991 Order only describes the booking of cellular investment. Where will income distribution be recorded?

Lewisport Telephone Company ("Lewisport")

1. Explain the rationale and authority for recording cellular investment in the "Non-Regulated Investments" account.

2. Will Lewisport receive its share of the net income of the cellular operations? If no, why not? If yes, in what account will it be recorded?

3. Are common employees and assets used in providing service to Lewisport Cablevision and Lewisport? If yes, provide a matrix showing how common costs are separated, and describe the nature and extent of the common activities.

4. With regard to your answer to Item 15 of the October 25, 1991 Order, explain how United States Cellular will finance the ongoing operations of the RSA?

5. Why did Lewisport choose to invest directly in cellular while the other TDS companies, Leslie County and Salem did not?

West Kentucky Rural Telephone Cooperative Corporation, Inc.

1. Explain the rationale and authority for recording cellular investment in Investments in Non-Affiliated Companies and net income or loss from the partnership in Other Non-Operating Income.

Harold Telephone Company, Inc.

1. Provide the support for charging Cellular MTSO $100 rent for central office space and $135.75 to cover carrying charges of cable repairs and pole expense repairs, etc.

2. Provide a narrative explaining the controls in place which will prevent cross-subsidy of cellular interests by the telephone companies. This narrative should include examples of how payroll and overheads of common employees are allocated.

3. What common costs are associated with the partnership being managed by your company? Describe the nature of these costs and provide an estimate of the total amount of common costs as well as the amounts allocated to each business.

Thacker-Grigsby Telephone Company, Inc.

1. Provide a narrative explaining the controls in place which will prevent cross-subsidy of cellular interests by the telephone company. This narrative should include examples of how payroll and overheads of common employees are allocated.

2. What common costs are associated with the partnership being managed by your company? Describe the nature of these costs and provide an estimate of the total amount of common costs as well as the amounts allocated to each business.

Done at Frankfort, Kentucky, this 6th day of April, 1992.

PUBLIC SERVICE COMMISSION

For the Commission

ATTEST:

Executive Director, Acting